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Federal Communications Commission
Office of Secretary

MEMORANDUM

Date: July 14, 1999

From: Tracey Wilson
Common Carrier Bureau
Policy & Program Planning Division
445 12 Street
5-C150
S.W., Washington, D.C.

To: Office of the Secretary
445 12 Street.
TW-B204F
S.W., Washington, D.C.

Subject: CC Docket 98-141

Please place the following letters into the record of CC Docket 98-141. If you require further information, please feel free to contact me at 202-418-1394. Thank you for your assistance.

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CC DKT. 98-141

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July 9, 1999

BY HAND DELIVERY **EX PARTE**

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Portals II
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Application of SBC Communications, Inc. and Ameritech Corporation for Authority To Transfer Control of Certain Licenses and Authorizations, CC Docket No. 98-141 – Written Ex Parte Presentation

Dear Ms. Salas:

By this letter, Ameritech Corporation ("Ameritech") and SBC Communications Inc. (collectively, the "Applicants") respond to the June 16, 1999 ex parte submission ("Comments") of the Indiana Utility Regulatory Commission ("IURC").

Although the IURC specifically stated that it "cannot comment on whether the merger should be approved" (Comments at 19), it raised four broad sets of issues that cast Ameritech Indiana in a negative light and can only be designed to prejudice the Commission against approval of the Applicants' merger at the eleventh hour. We note as a preliminary matter that a majority of the issues are irrelevant to the subject license transfer proceeding, as the Commission has recognized in other contexts, and fully within the jurisdiction of the IURC. Nonetheless, we address each of these issues below and point out the most important factual misstatements and assorted mischaracterizations in the IURC's filing.

I. Ameritech Indiana Does Not Resist State Regulation

The IURC's first allegation is that Ameritech Indiana actively resists state regulation and that its "extensive use of litigation has appreciably delayed competitive entry here in Indiana." Comments at 3.

Before addressing the IURC's three specific examples purporting to demonstrate Ameritech Indiana's litigious nature, an obvious proposition should be restated: the fact that Ameritech Indiana has chosen to exercise its constitutional rights is not tantamount to resisting state regulation. As this Commission has repeatedly recognized, such activity constitutes "constitutionally protected free speech" that is not the proper subject of scrutiny in a merger proceeding.[1]

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[1] Application of Pacific Telesis Group and SBC Communications Inc., Memorandum Opinion and Order, 12 FCC Rcd 2624, ¶ 37 (1997) ("SBC/Telesis"). In fact, the major IXCs have also engaged in extensive state and federal litigation in Indiana and the other Ameritech states concerning the rules governing access lines, interconnection to their networks and the decisions of state arbitrators. *See, e.g., MCI Telecommunications Corp. v. Indiana Bell*, Case No. 93A02-9803-EX-00204 (Ct. App. Ind. 1998) (unsuccessful appeal by MCI of intrastate PICC change order in IURC universal service docket); *Indiana Bell v. IURC*, Case No. IP97-0662-C-B/S (S.D. Ind., July 1, 1998) (court dismissed AT&T counterclaims in appeal of IURC arbitration order); *AT&T v. Indiana Bell*, Case No. 93A02-9805-EX-00438 (Ct. App. Ind., filed May 18, 1998) (appeal of IURC access charge order, withdrawn by AT&T); *MCI Telecommunications Corp. v. Illinois Bell*, Case No. 97-C-2225 (N.D. Ill. 1997) (appeal of IURC arbitration decision); *MCI Telecommunications Corp. v. Michigan Bell Telephone Co.*, Case No. 97-74362 (E.D. Mich) (pending appeal of Michigan PSC arbitration decision); *MCI Telecommunications Corp. v. Wisconsin Bell, Inc.*, Case No. 98-C-153-C (W.D. Wisc., filed Jan. 7, 1998) (appeal of Wisconsin PSC arbitration decision); and *AT&T*

(continued...)

Moreover, the IURC's argument (Comments at 6) that Ameritech Indiana's litigation posture delays competition is subject to challenge on at least three grounds. First, the IURC's perception concerning the state of competition in Indiana is neither current nor complete (see infra pp. 12-15). Second, the notion that the filing of a lawful appeal deters competition cannot withstand scrutiny. The IURC's argument ignores the fact that IURC orders remain in full force and effect absent a stay (see IC 8-1-3-6, attached as Exhibit 1) and that no stays have been entered in any of the cases cited by the IURC. Finally, all the evidence shows that Ameritech treats CLECs in Indiana just as well as it treats CLECs in its other states, so there should be equal incentives for CLECs to enter Indiana residential markets. In short, the IURC's argument selectively ignores both law and economic logic. We also address below the factual shortcomings of the argument.

A. Opportunity Indiana (Cause Nos. 39705 and 40849)

The IURC focuses first on Opportunity Indiana, the alternative price cap regulatory framework that went into effect in 1994. Comments at 4. When Opportunity Indiana expired a year and a half ago, the IURC adopted an interim alternate regulatory plan that required Ameritech Indiana to reduce its local exchange rates by 4.6%. Ameritech timely appealed this order. [2] As the IURC notes, this

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[1] (...continued)
Communications of Ohio Inc. v. Schriber, Case No. C2-99-414 (S.D. Ohio 1999) (appeal of Ohio PUC order on recovery of intraLATA presubscription costs).

[2] The full merits of Ameritech Indiana's position are set forth in its appellant's brief in that appeal, *Indiana Bell Telephone Co., Inc. v. IURC*, No. 93A02-9801-EX-22 (Ct. App. Ind.) (filed Aug. 27, 1998) (attached as Exhibit 2). That brief also refutes the IURC's insinuation that Ameritech Indiana has filed frivolous appeals to stymie competition.

appeal has been pending before the Indiana Court of Appeals for more than 18 months through no fault of Ameritech.

The IURC suggests that Ameritech Indiana has somehow acted improperly in not reducing its rates while the appeal is pending. Comments at 4. However, the IURC fails to disclose that, pursuant to IC-8-1-3-6, a public utility has the express right to charge and collect the former rate pending a decision on judicial appeal. Again, the legitimate exercise of lawful rights should not be equated with resisting state regulation.

The IURC also claims that Ameritech Indiana has fallen short on the infrastructure investment commitments it made pursuant to the Opportunity Indiana plan. In that plan, Ameritech Indiana committed to provide digital switching and transport facilities to every interested school, hospital and major government center. As Ameritech Indiana explained in complete detail in its Petition for Reconsideration in Cause No. 40849 (attached as Exhibit 3), it has complied with its investment commitments.[3] The IURC's comments ignore evidence submitted by Ameritech Indiana to confirm that it was meeting the express terms of the commitment, which was to provide infrastructure improvements to schools, hospitals and government entities that expressed an interest in such improvements.[4] For example, this evidence addressed the Commission's conclusion that Ameritech Indiana improperly included benefits provided to "grocery stores" and a "hotel." Evidence submitted by Ameritech Indiana showed that:

- The "grocery store" is a K through 12 content provider. The "grocery store" has an educational staff that is developing a healthcare and nutrition curriculum for use by schools. At the request of educators, necessary video equip-

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[3] The petition, minus its many exhibits, is attached hereto as Exhibit 3.

[4] Ameritech Indiana remains fully committed to the infrastructure investment agreed to in ¶ 10b of the Opportunity Indiana Settlement Agreement.

ment was installed at the "grocery store" and the company's local central office for transmission of the curriculum to interested schools

- The "hotel" in question is a facility used by the State of Indiana's Department of Education to train school administrators about state technology grants. In order to qualify for state technology grants, a school must have a technology plan filed with the Department of Education. For the last three years, the Department of Education has held a conference each year at the "hotel" to train school administrators about the Department of Education's technology plan filing process. Again, at the request of educators, Distance Learning technology and fiber was installed at the "hotel" to demonstrate the technology to the administrators and to develop the interest of administrators in participating in the Vision Athena network. Additionally, the conferences are televised via the network to interested schools.[5]

In fact, Ameritech Indiana has affirmatively responded to all hospital, school, university and government organization requests involving services covered by the infrastructure commitments. It has provided fiber optic facilities to every interested school, hospital and major government center in the company's service area. Ameritech Indiana continues to meet with the interested parties in an attempt to resolve any outstanding differences regarding the Opportunity Indiana commitment.

B. Universal Service (Cause No. 40785)

Nor is there any merit to the IURC's argument that Ameritech Indiana has thwarted regulation by filing appeals of the IURC's general investigation into universal service. Comments at 5. Ameritech Indiana has a genuine dispute with the IURC. Ameritech Indiana maintains that the IURC far exceeded the scope of Section 254 and the universal service mandate by, among other things, making

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[5] See Exhibit 3 at 12-15.

"confiscation" a Section 254 issue without any statutory basis therefor and applying Section 254 to *all* services (not just to the "universal services" contemplated in the 1996 Act). Ameritech Indiana appealed the "loop allocation" order issued in that case because the IURC, based on less than a scintilla of evidence (the testimony of one outlier party with little or no other support in the record for the conclusion), found that the cost of the loop should be allocated across all services and recovered from optional services instead of assigning 100% of the cost to basic local service. This non-cost- based approach to universal service directly challenges and contradicts the FCC's access reform process and other cost-based approaches designed to eliminate subsidies. Every other party to the proceeding opposed that outcome, and each of the other large ILECs in Indiana (Sprint and GTE) also appealed the order. As with all the other appeals taken by Ameritech Indiana since the 1996 Act went into effect, there is no stay, and Ameritech Indiana is following the order until the appeal is decided. Indeed, in this regard, Ameritech Indiana is actively participating in a sub-docket initiated by the IURC to assess Ameritech Indiana's compliance with the universal service orders.[6]

The IURC's discussion of recent developments in the Section 254 proceeding is similarly incomplete, as it omits several relevant facts. Most importantly, it implies that the IURC's February 19, 1999 docket entry in the subdocket sought information relating only to Ameritech Indiana's compliance with Section 254(k), when, in fact, the IURC requested substantial additional information not related to Section 254(k). Ameritech Indiana was originally given just over 60 days to complete cost studies for all universal services and submit substantial additional information, including material related to the question of confiscation.[7] Ameritech

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[6] The IURC's reference to "40875-S1" is incorrect - the docket is "40785-S1".

[7] *See, e.g.*, Docket Entry, Cause No. 40785-S1, Exhibit A thereto (IURC 2/19/99); Second Prehearing Conference Order, Cause No. 40785-S1, Exhibit A thereto (IURC 2/19/99). The IURC did extend the time for presenting cost

(continued...)

Indiana petitioned for reconsideration (see Exhibit 4), but also submitted its cost studies. On May 12, the IURC issued a docket entry requiring additional clarification and supplemental information. That docket entry did not reject the cost studies. Ameritech Indiana filed supplemental testimony on June 14, 1999, addressing the IURC's questions.

On July 6, 1999, the IURC issued another docket entry related to Ameritech Indiana's supplemental testimony filing. Again, this latest docket entry did not reject the cost studies, but found that Ameritech Indiana's supplemental response to one of four of the cost study requirement questions outlined in the May 12 docket entry was still deficient. The July 6 docket entry provides additional instructions to Ameritech Indiana in order to answer this question and directs Ameritech Indiana to file this information by September 1, 1999. With regard to the subject of confiscation, the IURC's May 12 docket entry stated that the Commission was unclear as to the direction Ameritech Indiana intended to take regarding its confiscation claim. The July 6 docket entry acknowledges that Ameritech Indiana's supplemental filing clarifies that Ameritech Indiana is not making a confiscation claim, and the IURC therefore finds that it will not consider any potential confiscation claim at this time.

C. Disputes Involving Interconnection Agreements

As an initial matter, the suggestion that Ameritech Indiana is using appeals from the interconnection approval process to delay anything is ludicrous. Only four of the more than sixty agreements entered into by Ameritech Indiana have been arbitrated; the remainder were either negotiated or adopted pursuant to Section 252(i) of the 1996 Act. Only two of the arbitrated agreements were subsequently appealed to federal court by Ameritech. Moreover, no stay was sought in any of the

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[7] (...continued)
studies an additional 28 days to April 29, 1999. *See* Docket Entry, Cause No. 40785-S1 (IURC 3/24/99).

interconnection appeals, including the AT&T case repeatedly cited by the IURC, and Ameritech Indiana performed under each of those agreements during and after the running of the appeals. In any event, the Commission has refused to consider such disputes in other merger proceedings, let alone find that they affect the transferee's qualifications,[8] and it should decline to do so here.

Similarly, the IURC's apparent claim that Ameritech Indiana is a tough negotiator was precisely the type of criticism considered and dismissed by the Commission in its approval of the SBC/Telesis merger, where the Commission concluded that "each individual act alleged by AT&T and ICG and admitted by applicants consists of either constitutionally protected free speech or business conduct that is legally permissible."[9] This conclusion applies with equal force in the

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[8] Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from; Southern New England Telecommunications Corporation, Transferor to SBC Communications, Inc. Transferee, Memorandum Opinion and Order, 13 FCC Rcd 21292, ¶ 29 (1998) ("SBC/SNET"); see also, Applications of Craig O. McCaw and American Tel. & Tel. Co., Memorandum Opinion and Order, 9 FCC Rcd 5836, ¶¶ 70, 86 (1994) ("AT&T/McCaw"); Applications of NYNEX Corp. and Bell Atl. Corp. for Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd 19985, ¶ 210 (1997) ("BA/NYNEX"); Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., Memorandum Opinion and Order, 13 FCC Rcd 18025 ¶ 216 (1998) ("MCI/WorldCom") ("an unresolved private contractual dispute . . . is not a sufficient basis to deny the merger as contrary to the public interest").

[9] SBC/Telesis ¶ 37 n.82. *See also Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc.*, 627 F.2d 919, 927 (9th Cir. 1980), *cert. denied*, 450 U.S. 921 (1981), *quoted with approval in Los Angeles Land Co. v. Brunswick Corp.*, 6 F.3d

(continued...)

instant proceeding. None of the IURC allegations concerning Ameritech Indiana's negotiating positions demonstrates anything to the contrary.

The IURC focuses on Golden Harbor's MFN adoption of the AT&T agreement under Section 252(i) (Comments at 6), but it fails to note that Golden Harbor delayed reaching agreement because it refused to accept the same termination date as the AT&T agreement that it was adopting. The IURC ultimately agreed with Ameritech Indiana that the termination date for the Golden Harbor agreement should be the same as the termination date of the AT&T agreement being adopted. In any event, the Golden Harbor case was unique because prior to that case the IURC's process for Section 252(i) MFN adoptions had not been clearly articulated and had not necessarily been followed by the agency. At least three prior MFN adoptions – those by LCI, MFS Intelenet and Focal -- had been approved under a different process. Finally, Ameritech Indiana believes that the IURC's "new" process first followed in Golden Harbor does not comport with federal law in that it fails to allow Ameritech Indiana the opportunity to prove that an MFN adoption is neither technically nor economically feasible, as required by 47 CFR § 51.809 and the Supreme Court's *Iowa Utilities Board* decision.[10]

II. The IURC Understates the Extent and Significance of the Competition for Local Telephone Service That Ameritech Indiana Faces

The IURC also complains about the allegedly limited extent of competition faced by Ameritech Indiana in the Indiana local exchange market. Comments at 6-12. The IURC's concern is misplaced. So long as Ameritech

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9 (...continued)
1422, 1427 (9th Cir. 1993), *cert. denied*, 510 U.S. 1197 (1994); *Northeastern Tel. Co. v. AT&T*, 651 F.2d 76, 79 (2d Cir. 1981), *cert. denied* 455 U.S. 943 (1982).

10 *AT&T v. Iowa Utilities Board*, 119 S.Ct. 721 (1999).

Indiana is complying with the requirements of Section 251, and there is no evidence that it is not, then the state of competition is beyond its control.

Moreover, the IURC's estimation of the extent of competition in the Indiana local exchange market is both outdated and based on an overly narrow view of what constitutes competition. The IURC's analysis only recognizes UNE and resale line loss as competition, thus ignoring even such basic measures as facilities-based competition by CLECs. Comments at 7-12. However, as both the Commission and the Department of Justice have recognized, such a constricted analysis does not provide an accurate picture of the competitive environment in Indiana or any other state.[11] In addition, the IURC's analysis is based largely on 1997 and 1998 data and ignores more recent trends in the competitive local exchange market.

Indiana is now experiencing further exponential growth in resale, UNE loops, bypass, total competitive lines, switch placement, EOI trunks and competitive NXX assignment. In addition, several hundred thousand Ameritech Indiana customers purchase intraLATA toll services, as well as other local and intraLATA services such as data, directory assistance, operator services, 800 service, Centrex and pay phone services, from other carriers. The actual state of competition in Indiana is well documented in the rebuttal testimony of Dr. Robert Harris, which was filed with the IURC June 25, 1999 and is attached as Exhibit 5 hereto. It demonstrates that when all forms of competition, including UNEs, resale, CLEC buildouts and customer bypass, are taken into account, Indiana is experiencing robust and rapidly growing local exchange competition.

While the levels of competitive activity appear to be higher in the other Ameritech states, this results from the choices of competitors, not the actions of

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[11] See, e.g., Application of Ameritech Michigan Pursuant to Section 271 To Provide In-Region, InterLATA Services In Michigan, Memorandum Opinion and Order, 12 FCC Rcd 20543 (1997); and the Evaluation of the Department of Justice, CC Docket No. 97-1137 (filed June 25, 1997).

Ameritech Indiana. Ameritech implements the same policies, interconnection agreements, collocation agreements, DA/OS services, right-of-way policies, number portability systems and OSS systems for resale, UNEs or interconnection, in Indiana as in Illinois, Michigan and the other Ameritech states which currently have more local competition. The same wholesale account managers and product managers serve the same CLECs, regardless of which Ameritech state they choose to serve. The same service centers serve CLECs in all five Ameritech states, using the same practices. The same teams represented Ameritech in interconnection agreement negotiations in all five states. In short, there are no Indiana-specific competition policies.

While the IURC may not be satisfied with the pace of the increase in competition, it cannot blame Ameritech Indiana. For example, there is a much higher level of competition in the business market than the residential market in Indiana. The reason is obvious: Indiana has among the lowest retail residential local exchange rates in the country. With rates for a residential local line, including local usage, as low as $10 per month, it is hardly surprising that few CLECs have entered the Indiana residential market. If there is less competitive activity, then it is not Ameritech but the CLECs, that have adopted different business strategies and efforts in the different states.[12]

Nonetheless, in our Voluntary Commitment filed with the IURC June 25, 1999, SBC and Ameritech indicated our willingness to take that extra step and commit to major competitive actions in order to induce competitors to enter the Indiana local market, especially the residential market. See Exhibit 6. These

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[12] For example, when AT&T announced its target of 25% local exchange market share for its Time Warner partnership and 30% for its Media One purchase in the next five years, it did not tell the stock analysts that it would reach these levels everywhere except Indiana or the Ameritech region. Its business decisions, are its own, as are those of MCI WorldCom and the hundreds of other CLECs.

commitments will alleviate any reasonable concern that the IURC may have about the impact of the proposed transaction on local competition. The commitments are wide-ranging, but they provide special attention to CLECs who wish to offer competitive services in the residential market. For example, we are prepared to commit to an option to implement discount programs for CLECs who will offer residential local service in competition with Ameritech Indiana. We also agree to improve Ameritech Indiana's OSS and to implement robust performance measurements, standards/benchmarks, and substantial remedies in connection with Ameritech Indiana's provision of OSS. The Voluntary Commitment also provides for an improved dispute resolution process for resolving operational issues with CLECs.

All CLECs that want to compete in Indiana will benefit from the Voluntary Commitment, and consumers stand to benefit most of all. In sum, Ameritech is highly confident that local competition, including residential competition, will continue to grow over the next several years in Indiana and all the Ameritech states. To back up our confidence, we are prepared to accept a significant penalty if, for whatever reason, competition fails to develop. Finally, the Voluntary Commitment will be supplemented by the conditions recently negotiated with the staff of this Commission.

III. The Status of Ameritech Indiana's Deployment of Broadband Capabilities In Indiana is Not An Issue For This Proceeding

The IURC is also critical of Ameritech Indiana because it does not currently deploy xDSL technology. Comments at 12-13. Ameritech Indiana's affiliate, AADS, is prepared to deploy that and other broadband technologies once the pending regulatory issues are decided in the Commission's Section 706 proceeding.[13] In any event, the status of Ameritech Indiana's deployment of xDSL is not an

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[13] See, Deployment of Wireline Services Offering Advanced Telecommunica-

(continued...)

issue that is in any way germane to this merger proceeding. Rather, as with other issues raised by the IURC, the public interest would be better served if this issue is dealt with in the context of the more focused Section 706 proceeding, which is addressing issues related to the deployment of xDSL and other broadband capabilities in all 50 states.[14]

IV. The Alleged Service Quality Problems Are Outside The Scope Of This Proceeding

The IURC also provides certain information which it apparently believes demonstrates that Ameritech Indiana provides less than adequate local exchange service. Comments at 14-15. In the first instance, the issue of service quality is outside the scope of this proceeding. As the Commission has recognized, state commissions can establish service quality benchmarks for intrastate service where they deem it appropriate, and the state commissions are the appropriate forums

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13 (...continued)
tions Capability, First Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 98-147 (March 31, 1999). The IURC's suggestion (Comments at 13) that Ameritech Indiana chooses not to deploy xDSL for fear of cannibalizing the revenue stream from selling second lines does not withstand simple mathematical analysis. Two access lines at $13 each would bring in $26 per month, less than half the revenue that xDSL would provide at $49.99 per month. Further, the deliberate rollout of xDSL lines in Indiana is not limited to Ameritech Indiana.

14 See SBC/SNET ¶ 29; AT&T/McCaw ¶ 70, 86.

for dealing with such issues.[15] Accordingly, these state issues are not appropriate for consideration by the FCC in the context of this merger application.[16]

In any event, the data in the Comments hardly suggests that there are major problems with Ameritech's service quality in Indiana. As the IURC admits, "[i]n most cases, Ameritech Indiana complied with the [IURC's] service standards ..." Comments at 14. Faced with this state of affairs, the IURC resorts to citing a potpourri of statistics culled at random from the Commission's ARMIS reports and surveys by J. D. Power and Associates in an attempt to demonstrate alleged shortcomings in Ameritech Indiana's service.[17] For example, rather than acknowledging those service categories where Ameritech Indiana's service is better than that of GTE

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15 See Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor to SBC Communications Inc., Transferee, Joint Opposition of SBC Communications and Ameritech Corporation to Petitions to Deny and Reply to Comments at Exhibit A, page 7, CC Docket 98-141 (November 16, 1998); SBC/SNET, ¶ 38, 63; BA/NYNEX ¶ 210 (concluding that review of performance measurement objectives is best addressed in ongoing rulemaking proceedings).

16 *See Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 375-378 (1986). In any event, even the IURC concedes that Ameritech Indiana has consistently met eight of the nine service quality standards set forth in the Indiana Administrative Code. Comments at 14. While the IURC criticizes Ameritech Indiana for failing to meet an alleged "out-of-service over 24 hours" standard, there is in fact no such standard in the Indiana Administrative Code.

17 Comments at 3 and 15-16. It should be noted that there is a benchmark for only one of the ARMIS categories discussed by the IURC – average installation interval for business customers – and Ameritech Indiana has consistently exceeded that benchmark.

or Sprint, the IURC instead compares the service levels to Ameritech's service in other states. The IURC also ignores 1998 and 1999 results when they are better than 1997 data. No amount of statistical manipulation can change the basic reality. Even in toto, these isolated facts do not demonstrate that Ameritech Indiana "has significant problems with quality of service," much less that the quality of service is germane to the Commission's inquiry in this proceeding.

Finally, various sections of the Voluntary Commitment and certain of the conditions negotiated with the Commission's staff directly address any concerns about the combined SBC/Ameritech commitment to service quality. See, e.g., Exhibit 6, Section IV (five points of service quality commitment and the $10 million annual incentive to meet such commitments). Moreover, Ameritech Indiana will be working diligently to adopt "best practices" from throughout the SBC and Ameritech regions to meet these service quality commitments.

Conclusion

Nothing in the IURC's submission should affect either the Commission's approval of this transaction or its decision as to whether or how to condition that approval.

Respectfully submitted,

Antoinette Cook Bush
Counsel to Ameritech Corporation

cc: Robert Atkinson
Thomas Krattenmaker
Michelle Carey
William Dever

Exhibit 1

Public Service Co. of Indiana, Inc., App. 3 Dist. 1979, 393 N.E.2d 776, [main volume] 181 Ind.App. 38.

request. Hidden Valley Lake Property Owners Ass'n v. HVL Utilities, Inc., App. 4 Dist.1983, 445 N.E.2d 575.

1-3-5 Service of papers

Sec. 5. A copy of any assignment of errors or of cross-errors filed in the court of appeals shall be served by mail, on or before the date of such filing, upon all parties or their attorneys of record as shown by the commission record filed. Copies of briefs shall be served, by mail, upon only the attorney general and those parties or their attorneys of record who have filed an appearance or assignment of errors with the clerk of the supreme court.

As amended by P.L.3-1989, SEC.53.

Historical and Statutory Notes

1989 Legislation

P.L.3-1989, Sec.53, emerg. eff. May 5, 1989, made corrective changes.

1-3-6 Presumption; rates, collection pending appeal

Sec. 6. All rules, practices, installations, and services prescribed, approved, or required by the commission shall be in force and shall be prima facie reasonable unless finally found otherwise by the court of appeals or by the supreme court if the cause is transferred to and decided by that court. However, pending the appeal as in this chapter provided, any municipally owned utility, public utility, rural electric membership corporation, or rural telephone cooperative association whose rate or rates are affected by the decision, ruling, or order appealed from shall have the right to collect the rate or rates as fixed by said decision, ruling, or order, or the former rate, whichever is higher in amount, and such municipally owned utility, public utility, corporation, or association shall refund the difference to each consumer or contract customer if such difference be not sustained upon appeal. However, pending the appeal as in this chapter provided, the court of appeals, upon good cause shown by verified petition, may authorize and permit, but not require, any common or contract carrier whose rate or rates are affected by the decision, ruling, or order appealed from, to collect the rate or rates published and in effect or the rate or rates sought to be put into effect, immediately prior to the commencement of the proceeding before the commission, subject to such provisions for bond or escrow as the court shall provide to protect the interest of all parties of record before the court.

As amended by P.L.384-1987(ss), SEC.8.

Historical and Statutory Notes

1987 Legislation

P.L.384-1987(ss), Sec.8, emerg. eff. retroactive to July 1, 1986.

Notes of Decisions

In general

Electric company was entitled to stay of rates pending appeal only during first generation appeal, not after rates had been declared unlawful by Supreme Court. Northern Indiana Public Service Co. v. Citizens Action Coalition of Indiana, Inc., 1986, 493 N.E.2d 762.

Exhibit 2

IN THE COURT OF APPEALS OF INDIANA

NO. 93A02-9801-EX-22

INDIANA BELL TELEPHONE COMPANY, INCORPORATED d/b/a AMERITECH INDIANA, Appellant, v. INDIANA UTILITY REGULATORY COMMISSION, OFFICE OF UTILITY CONSUMER COUNSELOR, SMITHVILLE TELEPHONE COMPANY, INC., TCG INDIANAPOLIS, INDIANA CABLE TELECOMMUNICATIONS ASSOCIATION, INC., AT&T COMMUNICATIONS OF INDIANA, INC., WORLDCOM, INC. d/b/a LDDS WORLDCOM, MCI TELECOMMUNICATIONS CORPORATION, SPRINT COMMUNICATIONS COMPANY, L.P., UNITED TELEPHONE COMPANY OF INDIANA, UNITED SENIOR ACTION OF INDIANA, INC., CITIZENS ACTION COALITION OF INDIANA, INC., AMERICAN ASSOCIATION OF RETIRED PERSONS, INC., SHARED TECHNOLOGIES FAIRCHILD TELECOM, INC., LCI INTERNATIONAL, INC., and TIME WARNER COMMUNICATIONS OF INDIANA, L.P., Appellees.	Appeal from the Indiana Utility Regulatory Commission IURC No. 40849 Hon. William D. McCarty, Chairman Hon. Mary Jo Huffman Hon. G. Richard Klein Hon. Camie Swanson-Hull Hon. David Ziegner Commissioners

BRIEF OF APPELLANT INDIANA BELL TELEPHONE COMPANY, INCORPORATED d/b/a AMERITECH INDIANA

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Statutes and Rules:

ISSUES PRESENTED

1. The Indiana Utility Regulatory Commission ("Commission") ordered a reduction, on an interim basis, in the rates of appellant Indiana Bell Telephone Company, Incorporated d/b/a Ameritech Indiana ("Ameritech") for basic local telephone service ("BLS"). The Commission ordered this reduction by using a "price cap index/productivity offset" type of ratemaking method, which it purportedly adopted pursuant to Ind. Code §§ 8-1-2.6 *et seq.* (the "Alternative Regulation Statute"). The first issue presented is whether the order reducing rates is unlawful because:

(a) The Commission adopted and used the new alternative regulation ratemaking method without proper notice and hearing and without finding that it meets specific statutory criteria, all in violation of the Alternative Regulation Statute.

(b) Neither the "productivity factor" nor the "inflation factor" the Commission used in applying its new ratemaking method is supported by the findings or by record evidence.

(c) Neither the findings nor the record evidence show a rational relationship between the rate reduction ordered and the current level of BLS rates compared to Ameritech's cost of providing that service, as required by both the federal Telecommunications Act of 1996 and the Alternative Regulation Statute.

(d) The Commission used its new alternative regulation ratemaking method to reduce rates but retained jurisdiction to exercise traditional rate regulation of earnings, contrary to both the findings and the Alternative Regulation Statute.

2. In the negotiated 1994 settlement agreement ("Settlement") approved by the Commission, which established an alternative regulatory structure for Ameritech through December

31, 1997, Ameritech agreed to make voluntary investments of $20 million per year for 1994 through 1999 for specified infrastructure to serve schools, hospitals and major government centers interested in advanced telecommunications technology. Through mid-1997, the direct investments required to provide the specified infrastructure to all interested entities were less than the maximums set forth in the Settlement. The second issue presented is whether the Commission's order is unlawful in changing and expanding Ameritech's obligations by requiring it to propose "other means" of spending amounts not needed for the infrastructure specified in the Settlement.

STATEMENT OF THE CASE

From June 30, 1994 through December 31, 1997, Ameritech was regulated based on the Commission's approval of the negotiated Settlement, which provided an alternative regulation plan under the Alternative Regulation Statute. The alternative regulation approved by Commission's June 30, 1994 Order is commonly known as "Opportunity Indiana." SR.3-61; App. 1-59.[1]

The Settlement created three categories of Ameritech services: (1) basic telephone services called Basic Local Service ("BLS"); (2) discretionary services called BLS-Related Services; and (3) competitive services called "Other Services." The Settlement fixed maximum prices Ameritech could charge for services in the BLS and BLS-Related categories. SR.24-25 (¶ 7b); App. 22-23. In

[1]The Record is cited as "R.___", and the Supplemental Record as "SR.___". Copies of the Commission's June 30, 1994 Order on Opportunity Indiana and the Settlement (which is Exhibits A-D to the June 30, 1994 Order) are contained in the separately-bound Appendix to this Brief, cited as "App." The Appendix also contains copies of several Commission orders in this proceeding, including the Final Order On Interim Relief which is the subject of Ameritech's appeal, portions of Federal Communication Commission orders cited herein, and the Alternative Regulation Statute, Ind. Code §§ 8-1-2.6 *et seq.* (App. 184-186).

contrast, prices in the "Other Services" category were regulated by competitive market forces subject to a price floor. SR.25-26 (¶ 7c); App. 23-24. The Settlement also required Ameritech to make price reductions cutting revenues by $57 million per year through a series of reductions in specified charges. SR.29 (¶ 8); App. 27; R.4870.

As part of the Settlement, Ameritech agreed to provide digital switching and transport infrastructure to every interested school, hospital, and major government center in its service area on a non-discriminatory basis. These investments were limited to $20 million per year for each year 1994 through 1999. SR.29-30 (¶ 10); App. 27-28. The Settlement further provided that it would "have no further legal force and effect with respect to the Settling Parties' rights and obligations" unless by December 31, 1997 the Commission entered an order in the future proceeding contemplated by the Settlement (described below). SR.32 (¶ 13); App. 30.

The Settlement and its regulatory structure for Ameritech had a term of three and a half years, expiring December 31, 1997. SR.20 (¶ 3); App. 18. The Settlement recited that it provided a "transitional regulatory framework" in a changing telecommunications market, the future of which the Settling Parties could not predict with certainty. SR.31 (¶ 13); App. 29. The Settlement therefore contemplated that the regulatory framework for Ameritech after December 31, 1997 would be determined in a future Commission proceeding, provided however that Ameritech (and other Settling Parties) could not petition the Commission to establish such a framework before May 1, 1997. *Id.*

On May 1, 1997, Ameritech filed a petition to establish that framework, just as the Settlement contemplated. Ameritech requested that the Commission order under the Alternative Regulation Statute an alternative regulatory framework for Ameritech (sometimes called "Opportunity Indiana II") to be effective after December 31, 1997. R.31-41. As contemplated by the Settlement, Ameritech requested that the Commission enter its order on the petition by December 31, 1997. R.41. Ameritech's petition further requested that, if such order was not entered by December 31, 1997, the Commission maintain the regulatory structure established by the Settlement (*i.e.*, Opportunity Indiana) pending the Commission's order on Ameritech's proposal for Opportunity Indiana II. *Id.* Thirteen entities, mostly competitors of Ameritech, intervened in the proceeding. The other intervenors were consumer groups collectively referred to as residential customers ("RC"). R.116, 119, 122. Appellee and cross-appellant Office of Utility Consumer Counselor ("OUCC") participated for the public.

After the parties failed to agree on a procedural schedule permitting completion and a permanent regulatory structure to be ordered for Ameritech by December 31, 1997, and the other parties objected to the extension of Opportunity Indiana on an interim basis, the Commission directed Ameritech to proceed separately on the issue of "interim relief" (*i.e.*, the regulatory structure that would apply after December 31, 1997 and until the Commission's order on Opportunity Indiana II). R.329-330; App. 64-65. From that point on, the case proceeded on two tracks: (1) the regulatory structure for Ameritech to replace Opportunity Indiana, sometimes referred to as "permanent relief" or the "main case" (on which the Commission has not yet entered an order and which is not at issue in the instant appeal); and (2) the interim regulatory structure for Ameritech, frequently referred to

as "interim relief," during the period between December 31, 1997 and the Commission's entry of an order on "permanent relief."

At a hearing on July 21, 1997, the presiding officers involuntarily dismissed Ameritech's first presentation of its request for "interim relief." R.3044-3113. The request for interim relief was subsequently reinstated by Commission order. R.863-864; App. 67-68. A second hearing was held September 30 through October 2, 1997. R.932, 3161. Near the close of the hearing, the presiding administrative law judge informed the parties that the schedule for filing briefs and proposed orders on the interim relief request would be fixed in an order to be issued on October 15, 1997. R.5394.

Instead of providing a briefing schedule, on October 15, 1997 the Commission entered a "Preliminary Order on Interim Relief" ("Preliminary Order") finding that "at least on an interim basis, some form of relaxed regulation is called for," but that continuing the current maximum prices ("price caps") for BLS would not serve the public interest. R.1345-1346, App. 82-83. The Commission found that the "public at large would be better served if the parties would present additional testimony" on the appropriate interim alternative regulation plan. R.1347, App. 84. The Preliminary Order also set forth a list of elements almost identical to those in the Settlement (*i.e.*, Opportunity Indiana) which the Commission found could be part of the interim regulatory framework. *Id.* Finally, the Commission provided Ameritech an opportunity to present, on an expedited schedule, a request for interim relief consistent with these preliminary findings. *Id.*[2]

[2]The Preliminary Order gave Ameritech 10 business days to develop and present a new proposal, two business days to prepare rebuttal testimony and two additional business days to prepare for hearing. R.1347; App. 84.

On October 29, 1997 Ameritech declined to file a third request for interim relief. R.1452. Ameritech explained that it had not requested a rate change in its petition, and that the issue of a change in the BLS price caps was significant and complex and could not be addressed properly within the expedited time frame provided. R.1455. Ameritech also informed the Commission that the evidence concerning the appropriate level for the BLS price caps could be presented in the main case on permanent relief, with the result that while the case was pending Ameritech would be subject to traditional regulation under Ind. Code §§ 8-1-2 *et seq.* (or, in certain instances, other standing Commission orders under the Alternative Regulation Statute). R.1461. After numerous briefs and docket entries following this filing, the third procedural schedule was vacated. R.2287-2288; App. 96-97. The parties were directed to file briefs and/or proposed orders based on the record as it currently stood but taking into account the Commission's findings in the Preliminary Order. R.2290-2291; App. 99-100.

On December 30, 1997, the Commission entered its Final Order on Interim Relief ("Final Order"), which is the subject of Ameritech's appeal. In the Final Order, the Commission (1) adopted a new pricing "concept" of using "a productivity offset to determine the appropriate level of a price cap" in an alternative regulatory structure; (2) found that a productivity factor of 6.5%, less an inflation factor of 1.9%, should be used to reduce Ameritech's BLS price caps from the levels in effect under the Settlement; and (3) consequently ordered Ameritech to reduce its rates for both residential and business BLS by 4.6%. R.2724-2728; App. 105-109. The Commission also revised Ameritech's infrastructure investment obligations as negotiated in the Settlement. It ruled that if Ameritech is unable to generate sufficient interest among schools, hospitals and government centers to absorb the full amount of the infrastructure investment obligation, Ameritech should "propose

some other means for its shareholders to provide infrastructure improvements consistent with [Settlement] paragraph 10(b)." R.2731; App. 112. The ordering paragraphs of the Final Order provide:

> 1. Ameritech Indiana's Petition for interim alternative regulatory relief pursuant to I.C. 8-1-2.6 *et seq.* is granted to the extent described above.
>
> 2. Subject to other ongoing rate investigations, until such time as this Commission issues an Order addressing the remainder of Ameritech Indiana's Petition other than for interim alternative regulatory relief, and subject to our further review if no such Order has been issued by October 1, 1998, this Commission shall relax is [*sic*] jurisdiction to review Ameritech Indiana's earnings. Ameritech Indiana shall accordingly reduce by 4.6 percent the cap currently in place on its residential and business rates for basic local service.
>
> 3. Ameritech Indiana shall make infrastructure investments of no less than $150 million through 1999 in compliance with the Settlements [*sic*] Agreement we approved in Cause No. 39705.
>
> 4. This Order shall be effective on and after the date of its approval.

R.2732; App. 113.[3]

STATEMENT OF FACTS

A. The Alternative Regulation Statute And Varieties Of Price Cap Regulation.

The Alternative Regulation Statute grants two types of authority to the Commission. First, under Section 2 (Ind. Code § 8-1-2.6-2), the Commission may, after notice and hearing, find that the public interest requires it to decline to exercise, in whole or in part, its jurisdiction over telephone companies or certain telephone services. Section 2 sets forth a number of factors which the Commission shall consider in determining whether the public interest will be served by such

[3]On December 30, 1997, the Commission also entered an Order on Third Appeal to the Full Commission, R.2714-2718, which apparently is the subject of OUCC's cross-appeal.

Commission action. Second, Section 3 (Ind. Code § 8-1-2.6-3) authorizes the Commission to use alternative regulatory procedures and generic standards, provided that it finds such procedure or standard serves the public interest and also promotes one or more of the additional criteria in Section 3. The Commission may act by adopting rules or by an order in a specific proceeding, but notice and hearing is required prior to Commission action.[4]

One alternative regulatory method, a type of which was adopted under Opportunity Indiana, is price cap regulation. The theory of price cap regulation is entirely different from rate-of-return regulation under the traditional regulatory statutes. R.4150. The basic theory of price cap regulation is that if a firm's prices are capped at a maximum level, and all profit constraints are removed, then a strong incentive to cut costs will be created. *Id.*

The most basic price cap plan is one that sets maximum prices for services and eliminates all profit constraints on the firm. R.4151. This form of price cap regulation does not provide a means to reflect productivity gains (cost decreases) through price reductions. Nor does it provide a means to reflect productivity losses (cost increases) through price increases. R.4153-4154.

Another type of price cap plan links the maximum price (or cap) to an index. The price cap index is an alternative regulation methodology for *changing* the maximum prices over time. R.4154-4155. Under this type of price cap plan, the maximum price is adjusted based on the interaction

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[4]The Commission may act under the Alternative Regulation Statute on its own motion, or at the request of the OUCC, one or more telephone companies, or any class satisfying the requirements of Ind. Code § 8-1-2-54. *See* Ind. Code §§ 8-1-2.6-2(a), 3(a).

between a price (inflation) index, known as an "Input Price Index," and presumed decreases in controllable costs, known as a "Productivity Factor." R.4153-4155. One of three price indices is usually used for the Input Price Index: the Consumer Price Index, the Produce Price Index or the Gross Domestic Product Price Index (GDPPI). R.4156. The Productivity Factor tracks productivity growth on an annual basis. R.4155. The historical productivity of the company is considered in determining the Productivity Factor. R.4157. A negative value for the Price Cap Index (*e.g.*, Input Price Index of 2% minus Productivity Factor of 8% = - 6%) indicates that a price reduction for the capped service is required. Conversely, a positive value for the price cap index shows the maximum allowable price increase for the service. R.4155.

Some types of price cap index plans, such as the one used by the Federal Communications Commission ("FCC"), also (1) recognize exogenous costs, to account for cost changes which are beyond control of the management, and (2) include mechanisms to share earnings. R.4153, 4164; *see also In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, 5 F.C.C.R. 6786, 6788, 6791-6792, 1990 FCC LEXIS 5301 (Part 1), **8, 39, 46 (Oct. 4, 1990) ("*Rules Concerning Rates*"), App. 116-117, 129, 132; *In the Matter of Price Cap Performance*, 12 F.C.C.R. 16642, 16711, 1997 FCC LEXIS 2725, **155 (May 21, 1997) ("*Price Cap Performance*"), App. 164.

B. The Price Cap Regulation And Relation Of BLS Price Caps To Cost Under The Settlement.

The alternative regulatory structure established by Opportunity Indiana classified Ameritech's services into three categories, each of which received different regulatory treatment and followed a

different set of operational procedures. SR.8; App. 6. The BLS category contains the service historically known as "plain old telephone service" -- voice-grade access to the network plus usage within the local calling area. The BLS-Related category includes discretionary services such as the basic custom calling features (call forwarding and three-way calling). The "Other Services" category includes competitive services such as Centrex, Dedicated Communication Services, Toll, 800 WATS, Operator Services and Directory Services, and new services. SR.23-24 (¶ 7a); App. 21-22.

For BLS and BLS-Related Services, the Settlement introduced the most basic form of price cap regulation -- substitution of price caps (maximum prices) in place of regulation of earnings. It did not specify components of a price cap index. R.4158. There is no Input Price Index, Productivity Factor, exogenous factor, or profit sharing mechanism in the Settlement. R.4160, 4164. Instead, the Settlement included specific rate decreases. SR.29 (¶ 8); App. 27. Ameritech was required to eliminate certain End User Common Line ("EUCL") and Touchtone charges through a scheduled series of reductions beginning May 1, 1994 and completed on June 1, 1996. *Id.* In contrast to a price cap index where prices may increase or decrease, these price reductions were guaranteed. R.4159. With one minor and limited exception, the Settlement also prohibited Ameritech from increasing any existing charge or imposing any additional charge for BLS or a BLS-Related Service. SR.25 (¶ 7b(ii)); App. 23.[5]

[5]In the Opportunity Indiana proceeding, Ameritech originally proposed a price cap index plan. R.4885. Virtually all other parties rejected use of such a plan as too complicated, and the parties never discussed productivity factors during negotiation of the Settlement. R.4885. The specific price reductions agreed to in the Settlement exceeded those that a price cap index may have required. R.4749.

The maximum prices for residential BLS established by the Settlement were lower than the prices charged by the other major telephone companies in Indiana in exchanges of like size. R.4877, 4908. The maximum prices for business BLS and for services in the BLS-Related category were similar to the prices of other major incumbent telephone companies. R.4877, 4908.

Ameritech's cost studies showed that the maximum prices for residential BLS established by the Settlement are below the cost of providing the service. R.3850-3851, 3942-3943, 4377-4379, 4706-4707, 4779, 4746, 4807-4809.[6] In contrast, the maximum prices for business BLS established by the Settlement exceed cost. R.3943. The Ameritech cost studies assigned 100% of the cost of the local loop to BLS since this cost is caused by basic dial tone service. R.4808. No other evidence was presented on the cost of providing BLS compared to the maximum BLS prices established by the Settlement, or on the proper treatment of the cost of the local loop.

C. Ameritech's Financial Performance During the Settlement Period.

By approving the Settlement, the Commission declined to exercise jurisdiction over Ameritech's financial matters and earnings during the 3 1/2 year period covered by the Settlement (the "Settlement Period"). SR.13-17; App. 11-15. Ameritech was not required to report its rate-of-return on regulated intrastate services during the Settlement Period. *Id.*

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[6]Cost refers to total service long run incremental cost ("TSLRIC") plus a reasonable share of joint and common costs. The Settlement required Ameritech to compute TSLRICs based on generally accepted cost study practices. SR.47; App. 45. TSLRIC is the forward-looking additional cost using least cost technology that is reasonably implementable based on currently available technology, of a telecommunications service that would be avoided if the provider had never offered the service or, alternatively, the total cost the company would incur if it were to initially offer the service for the entire current demand, given that the company already produces all of its other services. TSLRIC of an individual service does not include common costs. SR.45; App. 43.

The 1996 financial information for the total company, including interstate and intrastate, regulated and unregulated operations, showed total company revenues of $1,251,800,000. This was an increase in total revenues during the Settlement Period of $110 million. R.4419, 4873. Sixty-five percent (65%) of that total revenue increase (*i.e*, $72 million) occurred in services not regulated by the Commission and services not covered by the Settlement. R.4873. With regard to services covered by the Settlement, most of the revenue growth occurred in the competitive "Other Services" category not subject to price cap regulation, where overall annual growth rate between 1993 and 1996 was "reasonable" but "not spectacular." R.4727, 4871. In contrast, BLS revenues declined during the Settlement Period, and revenues for BLS-Related services grew at barely the rate of inflation. R.4727, 4871-4872.

For the year 1996, Ameritech's filings with the federal Securities and Exchange Commission indicated that it earned 38.8 percent return on average equity. R.4796, 2727; App. 108. This return included both interstate and intrastate services and unregulated as well as regulated services. *Id.* A significant driver of the growth in Ameritech's revenue was the robust economy in the State, which was in turn a part of highly favorable macroeconomic conditions in the U.S. as a whole. R.4728. During the Settlement Period companies in virtually all industries, including telecommunications, achieved record earnings. R.4730-4731.

D. Positions Of Other Parties On Interim Relief And Price Caps For BLS.

As noted above, Ameritech originally requested that the Commission continue the alternative regulatory structure provided by Opportunity Indiana for any interim period (*i.e.*, between January

1, 1998 and the date of its order providing a permanent replacement regulatory structure).[7] All of the active other parties opposed interim relief. R.4148, 4245, 4250-4251, 4411, 4640. RC proposed in the alternative that, if interim relief were granted, a decrease in BLS prices must be ordered or the rates made subject to refund, because (RC contended) the consumer parties to the Settlement intended further BLS price reductions to be part of any future alternative regulation relief. R.4148, 4149, 4163.

Under this alternative to denying interim relief, RC proposed a $0.67 per line rate reduction for BLS, an amount it contended was consistent with the intentions of the consumer parties when they agreed to the Settlement. R.4148, 4160, 4163. RC's witness said that the consumer groups intended by the rate reductions in the Settlement to achieve the outcomes expected from a price cap index without specifying the details of a price cap index, such as the proper inflation index and productivity offset. R.4160, 4164.

Based on this "consumer groups' intention" theory, RC's witness backed into a "price cap index" to support his proposed reduction in BLS rate. Specifically, he used the GDPPI for the Settlement Period but did not perform a productivity study. Rather, the witness determined the productivity factor in his price cap index by an "implicit" method that treated the elimination of the EUCL charge under Opportunity Indiana as productivity gains in the provision of BLS. R.4164. The

[7] As also previously noted, Ameritech later dropped its request for interim relief after the Commission's "Preliminary Order", which (1) indicated that an interim alternative regulatory structure would not be maintained with the price caps for BLS at the Opportunity Indiana levels; and (2) provided for further evidentiary proceedings on a severely compacted time frame.

"implicit" method used by the witness had no relationship to the analysis normally used to estimate a productivity factor. R.4746.

E. Commission Determinations On Interim BLS Price Caps.

The Commission did not accept RC's "implied" price cap index, but found that a presumption that the maximum BLS prices were reasonable was rebutted by the testimony of RC's witness. R.2726; App. 107. The Commission determined that BLS prices should be adjusted because (i) the mere passage of time should alter the cost factors contributing to a utility's bottom line; (ii) price caps are not intended to be static; and (iii) a utility experiencing net productivity gains after inflation can expect its costs to decrease. *Id.* Although not referring to any record evidence, the Commission said it was satisfied that Ameritech had experienced net productivity gains in the past and would continue to experience net productivity gains in the future.

The Commission also said it was "skeptical of Ameritech Indiana's attribution of 100% of the cost of the local loop to BLS customers and its corresponding assertion that BLS rates are already below cost." *Id.* While the Commission noted the issue was pending before it in another proceeding, the Commission rejected Ameritech's costing theories for purposes of interim relief in this proceeding. To support this conclusion, the Commission referred not to any record evidence but rather to a statement made by the FCC in another context. *Id.*; *see In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 F.C.C.R. 15499, 15846, 1996 FCC LEXIS 4312, **60 (Aug. 8, 1996) ("*Local Competition Provisions*"), App. 139-140.

The Commission also found that its agreement to relax its jurisdiction over Ameritech's earnings for the interim after December 31, 1997 in favor of a price cap necessarily depended on its determination of the appropriate level of the cap. R.2725; App. 106. The Commission said it "cannot find that the public interest would be served by keeping rates at the same level when Ameritech Indiana's filings with the federal Securities and Exchange Commission indicate that in 1996 it earned a 38.8 percent return on average equity." R.2727; App. 108. Although recognizing that this total company return included results from interstate and unregulated operations and was not specific to BLS and BLS-Related Services, the Commission found that "for purposes of assessing whether the public interest will be served by relinquishing pursuant to I.C. 8-1-2.6 our ability to review Ameritech Indiana's earnings, we find that its total return on average equity is not only relevant, but is highly probative." *Id.*

The Commission then adopted "the concept of using a productivity offset" to determine the appropriate level of price caps for an interim alternative regulation plan. *Id.* It then found that the interim BLS price caps "should take into account the [6.5%] productivity factor assigned to Ameritech Indiana by the FCC," *id.*, without noting that the FCC's factor relates to interstate access services, *see* R.4169. The Commission then used an inflation factor of 1.9% that was issued on December 23, 1997, after the close of the record, to reduce residential and business BLS rates 4.6%. R.2727; App. 108.

F. Infrastructure Investments During The Settlement Period.

Subject to the other provisions of the Settlement, Ameritech agreed to provide specified infrastructure investments for every interested school, hospital, and major government center in its

service area in an effort to jump start the utilization of advanced telecommunications technology. SR.29-30 (¶ 10); App. 27-28. The Settlement provided that these investments would not be recoverable in rates for rate-regulated services in any subsequent Commission proceeding. *Id.* These investments were limited to $20 million per year for 1994 through 1999, and to digital switching and transport facilities; they did not include the terminal and other equipment, software, hardware or customer training necessary to use data, video and other advanced telecommunications applications. *Id.* In order to facilitate utilization by schools, Ameritech also agreed to donate an additional $5 million per year to a non-profit educational organization. SR.29-30 (¶10(a)); App. 27-28.

The $20 million per year infrastructure investment amounts in the Settlement were based on the assumption that virtually all schools, hospitals and government centers would have an immediate interest. R.3785-3786. After approval of the Settlement, Ameritech carried on a very extensive program with customers in the schools, hospitals, and government centers. R.3898. Ameritech contacted every school district in the state, public and private, talking primarily with superintendents about the program. Ameritech contacted every hospital, attempting to contact the CEO in as many cases as possible, to make them aware of the program. Ameritech also contacted major government centers. *Id.*

It turned out that the demand for this infrastructure was less than originally projected. R.3897-3900. Through June 1997, interested schools, hospitals and government centers required direct expenditures of $15.6 million for infrastructure. R.3970. The lack of demand was attributable to gross underfunding for the purchase of new technology. R.4816. As to the money Ameritech did not invest in infrastructure directly for schools, hospitals and major government centers, it "probably

ended up in a lot of other facilities and investments that were not thought of at the time that Ameritech Indiana made its original proposal." R.3901-3902. Specifically, in the Opportunity Indiana proceeding, Ameritech projected that it would spend approximately $150 to $170 million on total infrastructure each year through the year 2000, including the infrastructure investments in the Settlement. R. 3759-3760. Ameritech's actual capital expenditures were:

1994	$140 million
1995	$154 million
1996	$202 million
1997	$201 million (projected)

Id.; *see also* R.4814, 4838. This totals $697 million and averages over $174 million per year.

G. Commission Determinations Concerning Infrastructure Obligations.

Based solely on the fact that Ameritech's direct infrastructure investments under the Settlement had been less than the maximum, $20 million per year, amounts provided, the Commission ruled that "Ameritech Indiana has failed to live up to its infrastructure investment obligation." R.2730; App. 111. Without referring to Ameritech's total infrastructure investments during 1994-1997, which exceeded the amounts Ameritech said it would spend in total, the Commission stated that "if Ameritech Indiana is encountering obstacles to spending the money it promised to spend, the solution is not for it to pocket the approximately $44 million difference . . . ." R.2730-2731; App. 111-112. The Commission directed that if Ameritech "has trouble generating sufficient interest it should try harder . . . to generate interest in its provision of digital switching and transport facilities" or "otherwise propose some other means for its shareholders to provide infrastructure improvements consistent with [Settlement] paragraph 10(b)." R.2731; App. 112.

SUMMARY OF ARGUMENT

This appeal concerns the scope and limits of the Commission's legal authority to order involuntary reductions in a utility's rates pursuant to the Alternative Regulation Statute rather than the traditional ratemaking methodology under the Public Service Commission Act of 1913. The appeal also concerns the Commission's legal authority to rewrite the terms of a previously approved settlement agreement, and by that means compel Ameritech to make involuntary and uncompensated investments.

The Commission's Order that Ameritech reduce its residential and business BLS rates is unlawful for several reasons. As an initial matter, the Commission violated the Alternative Regulation Statute by proceeding on its own motion to impose a new alternative regulation ratemaking method without proper notice or hearing. The Commission further violated the terms of that Statute by imposing the new ratemaking method without the necessary findings that the price cap index and productivity offset concept, the specific alternative methodology it adopted, serves the public interest as statutorily defined and also promotes one or more of the additional statutory criteria. These procedural requirements are not mere "technicalities" to be disregarded at the Commission's convenience. They are essential statutory prerequisites safeguarding from abuse the Commission's authority, conferred by the Alternative Regulation Statute, to override the procedures and substantive standards of other, longstanding utility regulation statutes.

Having violated these requirements of the Alternative Regulation Statute, and in part *because* it did so, the Commission took additional shortcuts that violate other legal requirements, including that its decisions be supported by adequate findings and record evidence. To implement its new

alternative ratemaking methodology, the Commission used an FCC productivity factor -- with no finding and no evidence that this factor for interstate access services is appropriate for the intrastate BLS at issue. The Commission further used an inflation factor published after the close of the record -- with no finding and no evidence of the appropriateness of either the inflation index chosen or the specific factor used.

The Commission also acted without finding, and with no evidence, that the reduced BLS rates it ordered cover the cost of providing the service. Indeed, the uncontradicted evidence is that the existing rates for residential BLS are below cost. Even if productivity gains occur, this is no reason to assume -- and there is no finding and no evidence to show -- either that such productivity gains occur in BLS, or that any supposed gains which do occur are of such magnitude as to make the previously below-cost rates rise above the cost of service. In place of the necessary findings and evidence, the Order relies entirely on unsupported generalizations and plainly fallacious reasoning. For example, the Commission says that "greater usage of [Ameritech's] installed plant" and "further allocation of costs" should lower BLS "cost per use" -- when there is no evidence that the further allocation of costs is reasonable. Even if there were such evidence, it would be irrelevant because the Commission's reasoning is inherently flawed. Under both the Settlement and Indiana law, BLS is priced on a flat rate -- *not* a "usage" -- basis.

If the price for residential BLS does not cover the cost of providing that service -- as uncontradicted record evidence shows -- then that service is being subsidized implicitly through the pricing of other services. Today, this social pricing philosophy is unlawful because a utility cannot sustain artificially high prices for competitive services in order to subsidize artificially low prices for

BLS. If the utility does maintain the artificially high prices, it will lose its customers for those services to competitors. If the utility does not maintain the artificially high prices, it will not recover its cost of service. That is why the Telecommunications Act of 1996, 47 U.S.C. § 254(e), requires the implicit subsidies of basic services to be eliminated, or else made explicit and funded through nondiscriminatory funding mechanisms. The Commission acted unlawfully in ordering Ameritech to reduce its BLS prices under the newly adopted alternative regulation ratemaking method without first performing the cost studies necessary to determine whether Ameritech's cost of providing the service would be recovered through the reduced price. The Order is contrary to the Alternative Regulation Statute for the same reason.

The Commission's Order reducing rates is also unlawful because the Order does not even do what the Commission said it was going to do. The Commission said that its "agreement to relax our jurisdiction for the interim over Ameritech Indiana's earnings after December 31, 1997 in favor of a cap on Ameritech Indiana's rates necessarily depends on our determination of the appropriate level of the cap." However, the Commission then adjusted the price cap downward but *retained* jurisdiction to conduct a traditional earnings review in another pending docket. This aspect of the Order is contrary not only to the Commission's own finding but also the intent of the Alternative Regulation Statute -- which is to cease regulation altogether or replace traditional regulation with new alternative regulation standards and procedures, *not* to superimpose new alternative regulation on top of existing traditional regulation.

The Commission's apparent objective all along, as evidenced by its orders on interim relief, was to take back some of Ameritech's earnings by imposing an ever-popular reduction in BLS rates.

The presiding officers dismissed the first interim relief request where no rate reductions were proposed. Next the Commission tried to steer the parties to its desired outcome, indicating that an alternative regulatory plan could be approved if it included a BLS rate reduction and encouraging settlement negotiations. When this did not produce voluntary agreement to the desired outcome, the Commission proceeded to reduce BLS rates without an evidentiary basis and without regard to the limitations on its statutory authority.

Ameritech had the right to have its request for interim relief heard on the merits. If the Commission found that it was not in the public interest to grant relief under the Alternative Regulation Statute while maintaining the current BLS price caps, the Commission was required to deny Ameritech's request. This would leave Ameritech to operate under traditional regulation. If the Commission believed that further action on its part was necessary, it had two lawful alternatives: (1) proceed with a traditional rate investigation of non-competitive services; or (2) commence a proceeding to adopt a new alternative regulation ratemaking standard in accordance with the statutory requirements, and *thereafter* apply the new ratemaking standard to rates. The Commission did neither. Instead, it short-cut the statutory and evidentiary requirements and Ameritech's due process rights to reduce BLS rates without regard to the means used or the evidentiary record. Accordingly, that part of the Order relating to the "productivity concept" and its application to reduce Ameritech's BLS rates must be vacated.

The part of the Order regarding infrastructure investments is also erroneous. The Commission erred as a matter of law in ordering Ameritech to find some other way -- *i.e.*, some way other than provided in the Settlement -- to make the investments. The only lawful basis for requiring Ameritech

to make the infrastructure investments at all is its voluntarily-assumed obligations set forth in the negotiated Settlement itself. The Commission has no legal authority to rewrite the Settlement after-the-fact and compel Ameritech to make uncompensated investments in ways or for purposes to which it never agreed.

ARGUMENT

I. STANDARD OF REVIEW.

Judicial review of Commission orders has three key components, each of which is involved in Ameritech's appeal.

First, the Commission's legal conclusions and decision must be supported by specific and legally adequate findings. "[T]his court first determines whether the Commission included in its decision *specific* findings on *all* factual determinations material to the ultimate conclusion." *Gary-Hobart Water Corp. v. Indiana Utility Regulatory Comm'n*, 591 N.E.2d 649, 652 (Ind. Ct. App. 1992) (emphasis added). *Accord, e.g., General Motors Corp. v. Indianapolis Power & Light Co.*, 654 N.E.2d 752, 757 (Ind. Ct. App. 1995). Under this standard, "[t]he findings of basic fact must reveal the [Commission's] analysis of the evidence and its determination therefrom regarding the various specific issues of fact which bear on the particular claim." *Gary-Hobart Water Corp.*, 591 N.E.2d at 652, *quoting Perez v. United States Steel Corp.*, 426 N.E.2d 29, 33 (Ind. 1981). There must also be "[a] rational relationship between the facts found and the conclusion reached . . . ." *V.I.P. Limousine Service, Inc. v. Herider-Sindess, Inc.*, 171 Ind. App. 109, 115, 355 N.E.2d 441, 445 (1976).